TOPIC 17

INDAS-21

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

INDEX

S.No.	Content	Page No.
1	Key Definitions	394
2	Important Case Studies on Functional Currency	398
3	Monetary Vs. Non-Monetary	400
4	Brief Approach	401
5	Foreign Currency Transactions	401
6	Net Investment in Foreign Operation	404
7.	Change in Functional Currency	407
8.	Foreign Currency Financial Statements	408
9.	How to Translate FS of Foreign Operation	409
10.	Disposal of Foreign Operation	412
11.	Additional Questions	414

Quote:-

"You learn more from failure than from success"

SCOPE

- Accounting for transactions and balances in foreign currencies
- Translation of results and financial position of foreign operations
- Translation of financial statements into a presentation currency

EXCLUSIONS

- Derivative transactions and balances that are within the scope of Ind AS 109 (Financial Instruments: Recognition and Measurement). However, this standard applies to translation of derivatives from functional currency to presentation currency.
- Hedge accounting for foreign currency items, including net investment in foreign operation – Covered by Ind AS 109
- Presentation in statement of cash flows of transactions in a foreign currency or of a foreign operation (Ind AS 7 Statement of Cash Flows)

KEY DEFINITIONS

Foreign Currency	Functional Currency	Presentation Currency	Foreign Operation
is a currency other than the *Functional Currency* of the entity.	is the currency of the *primary economic environment in which the entity operates.* In this regard, the primary economic environment will normally be the one in which entity primarily generates and expends cash i.e. it operates.	is the currency in which Financial Statements are presented. Presentation currency may be different from entity's Functional Currency. It may be more than one.	is an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

CHANGED TERMINOLOGY

AS 11

- **Reporting currency** is the currency in which an enterprise **presents** its financial Statements

IndAS 21

- **Functional currency** is the currency of the **primary economic environment** in which the entity operates.

  To determine Functional Currency Entity should - Emphasise the currency that **determines the pricing of the transactions that it undertakes,** rather than focusing on the currency in which those transactions are denominated.

Primary Economic Enviroment

In Which The Entity Primarily Generates And Expends Cash			
Primary Indicators		**Other Indicators**	
Currency that mainly influence **SALE PRICE** of goods and services and Currency of the country **whose competitive forces and regulations determine the sale prices** of its goods and services	Currency that mainly influence COST - Labour, Material and other Cost.	Currency in which **funds from financing activities are generated.**	Currency in which receipts from operating activities are **retained.**

Choice of Functional Currency

1. An entity does not have a free choice of functional currency
2. An entity cannot change functional currency unless facts and circumstances relevant to its determination are change.

Functional Currency of Foreign Operation:

Functional Currency is same as that of Reporting Entity's Currency	Functional Currency may be different that of Reporting Entity's Currency
Whether the activities of foreign operations are carried out as an extension of that reporting entity rather than being carried out with a significant degree of autonomy. **For Example:** If the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. In practice, the functional currency of a foreign operation that is **integral to the group** will usually be the same as that of the parent.	When the activities are carried out with a **significant degree of autonomy** and independently from reporting entity. **For Example:** when the foreign operations accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.

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Q184

Future Ltd. sells a revitalizing energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$ what is the functional currency of Future Ltd.?

Solution

The functional currency of Future Ltd. is the L$ Looking at the primary indicators, the facts presented indicate that the currency that mainly influences the cost of producing the energy drink is the L$. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

Q185

Small India Private Limited, a subsidiary of Big Inc., takes orders from Indian customers for Big's merchandise and then bills and collects for the sale of the merchandise. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. What is small's functional currency?

Solution

Small, although based in India with its cash inflows generated within India, is essentially a "pass through company" established by its parent. Small is totally reliant on Big for financing and goods to be sold, despite the fact that goods are sold within India and in Indian Rupees. Therefore, small is not a self-contained entity within India, but rather an entity that relies on its parent. This reliance translates into a reliance on the parent's functional currency, the US Dollar. Therefore, the primary economic environment is US and thus the functional currency is the US Dollar. Therefore, Small India Private Limited would have the US Dollar as it functional currency and hence any receivables or payables of the branch or subsidiary denominated in currencies other than the US Dollar would be remeasured into the US Dollar at the current rate, and changes in the exchange rate would result in an exchange gain or loss to be included in net income.

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CASE STUDIES ON FUNCTIONAL CURRENCY

Case Study -1

1. M Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA.
2. Purchases are done in USD and are based on prices in the US Market
3. It sells goods in USD and the sale price is influenced by the holding company.
4. Other expenses are incurred locally.
5. M Ltd. has an External Commercial Borrowing from A Inc. For financing its activities.

Solutions:

Factors (M Ltd.)	Influenced by which Currency
Sales	USD
Sales Market Influenced by	USD
Expenses	INR
Purchases	USD
Financing	USD
Cash flows	USD/INR
Functional Currency (Based on Above)	**USD**

The above conclusions are based on Primary indicators

Case Study 2

1. N Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA.
2. Purchases are done in USD and are based on prices in US Market.
3. It **sells** goods in **INR** but the sale price is influenced by the country of the holding company.
4. Other expenses are incurred locally.
5. N Ltd. has an External Commercial Borrowing from A Inc. for financing its activities.

Solution:

Factors (N Ltd.)	Influenced by which Currency
Sales	INR
Sales Market Influenced by	USD
Expenses	INR
Purchases	USD
Financing	USD
Cash flows	USD/INR
Functional Currency (Based on Above)	**USD**

The above conclusions are based on Primary indicators

Case Study 3

1. USA Ltd (U) owns a subsidiary in India, Dragon Ltd (D).
2. D assembles all goods in India using a **combination** of **locally** sourced materials and materials **manufactured by U**.
3. All goods are then exported and **sold in Australia**, based on selling prices determined by U and influenced by Indian market.
4. The company has a **loan from an Indian Bank**.

Solution:

Factors (Dragon Ltd.)	Influenced by which Currency
Sales	AUD
Sales Market Influenced by	INR
Expenses	INR
Purchases	INR/USD
Financing	INR
Cash flows	USD/INR/AUD
Functional Currency (Based on Above)	**INR**

The above conclusions are based on Primary indicators

Case Study 4

1. X Ltd., a subsidiary in India, purchases goods from A Inc., its holding company in USA.
2. Purchases are done in USD and are based on prices in US Market.
3. It sells goods in INR and the sale price is market determined.
4. Other expenses are incurred locally.
5. It remits its proceeds to the holding company.

Solution:

- Sales are in INR and are market determined whereas goods are purchased from USA.
- The primary indicators do not give a clear picture.
- On the basis of **additional factors**, in the given case X Ltd. is carrying out its activities as an extension of holding company's foreign operations since it only sells goods imported from the reporting entity and remits its proceeds to it, its functional currency should **be USD.**

MONETARY vs. NON-MONETARY ITEMS

Monetary items	Non-monetary item
Units of currency held and assets and liabilities to be received or paid are in a fixed or determinable number of units of currency.	There is no fixed or determinable number of units of currency
Most debt securities are considered as monetary items because their contractual cash flows are fixed or determinable	

➢ Examples of Monetary items include:

- pensions and other employee benefits to be paid in cash;
- provisions that are to be settled in cash;
- cash dividends that are recognized as a liability;
- Contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value* to be received (or delivered) equals a fixed or determinable number of units of currency.

➢ Examples of non-monetary items include:

- amounts prepaid for goods and services (e.g., prepaid rent) and income received in advance, on the basis that no money will be paid or received in the future;
- goodwill;
- intangible assets;
- inventories;
- property, plant and equipment;
- Provisions that are to be settled by the delivery of a non-monetary asset.

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BRIEF APPROACH

Transaction in Foreign Currency? **Yes**	Translate that transaction into Functional Currency initially and on every BS date translate the FCMI again. Now, is ur Presentation Currency different from Functional Currency? **Yes**	Ok No problem, Translate ur Entire Balance sheet and Profit & Loss items from Functional Currency to Presentation Currency. **done** **Happy ☺**

FOREIGN CURRENCY TRANSACTIONS

Steps to account and report for foreign currency transactions:

- Determine the functional currency of all reporting entities as explained above i.e. Standalone Entity, An entity with Foreign Operation (Parent) or Foreign Operation (Subsidiary or Branch).
- **Translate** the foreign transactions/items into its functional currency.
- Record and report the effect of such translation

Initial Recognition:

- Recognize transaction at the **SPOT RATE** i.e. the Exchange rate on transaction date.
- May use e.g. average rate for week or month as a practical approximation.
- Average rate not reliable if currency fluctuates significantly.

Subsequent Measurement:

Financial Statement Items	**Exchange Rates**
Monetary Items	Rate at the Reporting Date (i.e. Closing Rate)
Non-Monetary items at historical cost	Rate at the date of transaction
Revalued Non-monetary items or Measured at Fair Value. **For example :** 1. Biological assets 2. Financial instruments	Rate at the date of Fair valuation. Example: the cost or carrying amount, as appropriate, is translated at the exchange rate at the date when that amount was determined; and the net realisable value or recoverable amount, as appropriate, is translated at the exchange rate at the date when that value was determined.

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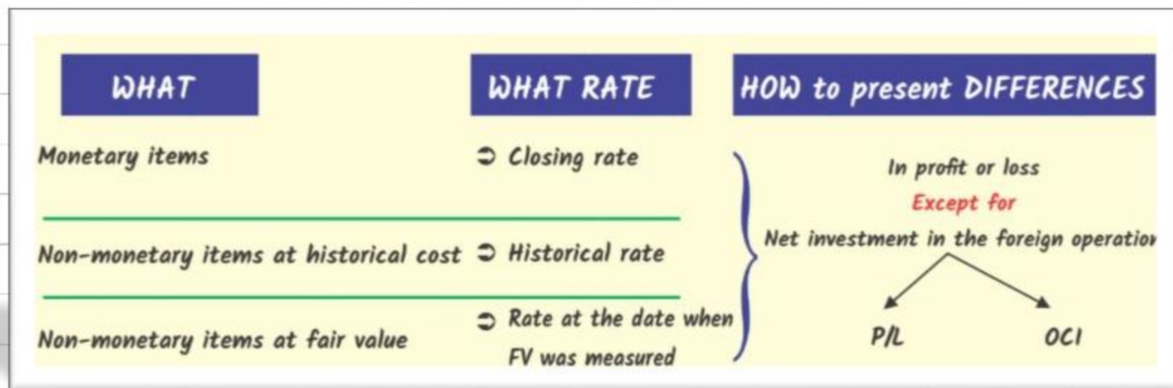


TREATMENT OF EXCHANGE DIFFERENCE ON TRANSLATION OF FOREIGN CURRENCY TO FUNCTIONAL CURRENCY:

General Rule:	Non-monetary items which are measured at fair value other than cost through OCI	Net Investment in Foreign Operation	LTFCMI – if Option is availed under IndAS 101
Exchange difference is transferred to Profit and loss account in case of FCMI & In case of Non-Monetary items measured at fair value through P&L	Exchange difference to be transferred to OCI Example – Revaluation Surplus under INDAS 16 & Equity instruments measured at FVTOCI (IndAS-109)	Foreign exchange difference arises from monetary item that forms part of net investment in foreign operation. To be recognised in OCI and accumulated in Equity To be reclassified from Equity to P&L on disposal of the investment	Option to recognize and accumulate ED arising on restatement of LTFCMI directly in separate component of equity (FCMIT Difference A/c) Accumulated amount will be transferred to P&l over the period of maturity, in an appropriate manner.

Q186.

1. Company Apple's functional currency is INR
2. On 01.01.2017 company buys a building for US $100,000
3. The exchange rate is INR 54.48 per US $
4. Company Apple's year end, 31st March
5. The building is not depreciated as it is not yet available for use
6. On 31.03.2017 the exchange rate is INR 55.54 per US $ and the value of building is US $110,000

Solution:

Initial Recognition

- On 01.01.2017 the building is capitalized at the rate at the transaction date

Building Dr	54,48,000	
To Bank Cr		54,48,000

Subsequent Recognition

- If cost model adopted as accounting policy under IndAS 16 for PPE, Building is carried at its historical cost, hence no adjustment to be made
- If revaluation model adopted as accounting policy under IndAS 16 for PPE, value of building to be adjusted for revised value.
- Hence the building being a non-monetary item and held at fair value, is to be translated at the date of valuation

Building Dr	661,400	
To Revaluation Reserve Cr		661,400

Revaluation reserve includes exchange component ($ 100000 * (55.54-54.48)) + ($ 10000 *55.54)

NET INVESTMENT IN A FOREIGN OPERATION:

Meaning: If an entity is having monetary item that is receivable from or payable to a foreign operation (say foreign subsidiary) for which settlement is neither planned nor likely to occur in foreseeable future.

Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.

Example: An entity has two subsidiaries A and B. Subsidiary B is a foreign operation. Subsidiary A grants a loan to Sub. B. Sub. A's loan receivable from Sub B would be part of the entity's net investment in Sub. B if settlement of the loan is neither planned not likely to occur in the foreseeable future.

Treatment of Exchange difference: Exchange difference arising on a monetary item that form part of a reporting entity's net investment in a foreign operation shall be treated in the following manner:

SEPARATE FINANCIAL STATEMENTS OF REPORTING ENTITY (i.e. foreign entity)	CONSOLIDATED FINANCIAL STATEMENTS OF REPORTING ENTITY (i.e. parent entity)
Exchange difference shall be recognized in the Profit and loss A/c.	Exchange difference shall be recognized initially in Other Comprehensive Income (OCI) and reclassified from equity to Profit and Loss A/c on disposal of the Net Investment.

However, an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting entity's net investment in that operation because an associate is not a group entity.

Q187

An Entity A has a foreign subsidiary B whose functional currency is Euro (B). The Functional Currency of the entity A is Dollar. On 1st Jan, 2016 when the exchange rate was $1= 1.5 Euro, Entity A has given loan to subsidiary B of $ 3 Million. On 31st December, 2016 the loan has not been repaid and is regarded as a part of net investment in the foreign subsidiary, as settlement of the loan is neither planned nor likely to occur in the foreseeable future. The

exchange rate on 31st Dec, 2016 is $1 = 2 Euro and the average rate for the year was $1 = 1.75 Euro. How this loan would be treated in the entity A's and group financial statement?

Solution:

There is no exchange difference in the entity A's financial statements, as the loan has been made in dollars. In the foreign subsidiary's financial statements, the loan is translated into its own functional currency (Euro) at the rate of $1 = 1.5 Euro or 4.5 million Euro as of 1st Jan, 2016. At the year-end 31st Dec, 2016, the closing rate will be used to translate this loan. This will result in the loan being restated at 6 million Euro ($3 million x 2), giving an exchange loss of 1.5 million Euro, which will be shown in the subsidiary's (B) Profit and Loss account.

In the group financial statements, this exchange loss will be translated at the average rate, as it is in the subsidiary's Profit and Loss account item, giving loss of $8,57,000 (Euro 1.5 million / 1.75). This will be recognised in the equity.

Q188

Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S for EURO 300. At the reporting date, though the amount is yet to be received from S, the payment is expected to be made in the foreseeable future. In addition to the trading balances between P and S, P has lent an amount of EURO 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference be recognised in the profit and loss account?

Solution

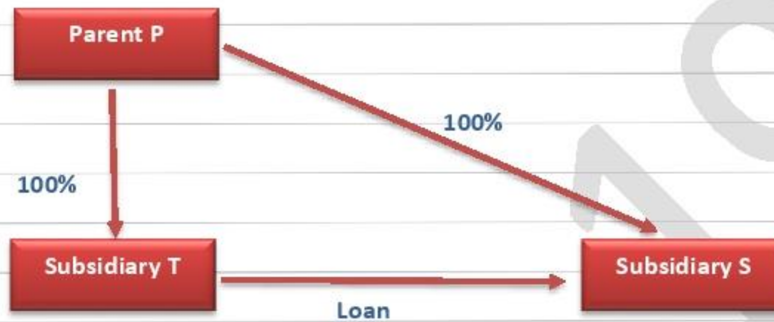
The exchange gain or loss incurred by P on the trading balance should be recognised in profit or loss. Even if repayment was not due for three years (for example) or even longer, but if repayment is still planned, then the gain or loss should be recognised in profit or loss.

The amount lent by P should be regarded as part of its permanent funding to S. Thus, the exchange gain or loss incurred by S on the EURO 500 loan should be recognised in profit or loss in S's separate financial statements, but recognised in other comprehensive income and presented within equity in the consolidated financial statements of P.

Q189 (ICAI)

Modifying the above Question 188, suppose that for tax reasons, the 'permanent' funding extended to S is made via another entity in the group, T, rather than from P directly i.e., on the directions of P, T gives the loan to S. Where the exchange differences should be recognised?

Solution



Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group's point of view the funding relates to an investment in a foreign operation. This is the case irrespective of the currency in which the loan is denominated. So if the loan is denominated in T's functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

Student Notes:-

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CHANGE IN FUNCTIONAL CURRENCY

1. Only if there is a change to the underlying transactions, events and conditions (i.e. Change in Primary economic environment in which entity operates)
2. Translation procedures should be applied to the new functional currency ***prospectively from the date of the change.***

i. All items (Assets, Liabilities, Equity, Expenses & Incomes) are translated into the new functional currency using the exchange rate at the date of change.

ii. Resulting translated amounts for non-monetary items are treated as their historical costs.

iii. Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation.

iv. Exchange gain or loss from long-term monetary items accumulated in equity (where such option is exercised) are not transferred to profit or loss immediately on change of the entity's functional currency

Example

A, located in Germany, is a wholly owned subsidiary of Z. $ is Z's functional currency. € is A's functional currency as all sales, purchases and labour costs were in €. Z started using A's facility to meet its orders. A closed down its sales department as 80% of its supplies would be to Z. Z built a new facility to produce materials required in its manufacturing process and A started receiving all material from Z. A now expects cash inflows and outflows, except for wages in $.

The currency of revenues has changed from € to $. It seems to be permanent as the sales dept. has been closed. Currency of outflows has changed from € to $. Position of A within Z's overall operating strategy has changed from self-supporting, standalone entity to a manufacturing facility of Z. There will be a change in the functional currency from € to $.

FOREIGN CURRENCY FINANCIAL STATEMENTS

- If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency.
- For consolidation purpose, if group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

TRANSLATION TO PRESENTATION CURRENCY

Case – I If the functional currency (of the entity whose financial statements are to be translated into presentation currency) is not currency of a hyperinflationary economy:

ASSETS & LIABILITIES	RATE AT REPORTING DATE
INCOME & EXPENSES AND CAPITAL TRANSACTIONS	RATE AT THE DATE OF TRANSACTION (OR AVERAGE RATE)
ALL THE RESULTING EXCHANGE DIFFERENCES CLASSIFIED AS OCI (Such differences to be transferred to P&L on disposal)	

WHAT	WHAT RATE	HOW to present DIFFERENCES
Assets (Including goodwill) and liabilities	⊃ Closing rate	In other comprehensive income CTD
Income and expenses	⊃ Historical rate (average)	
Share capital/equoty items	⊃ Not specified	

Case – 2 If the functional currency (of the entity whose financial statements are to be translated into presentation currency) is currency of a hyperinflationary economy:

Assets, liabilities, equity items, Income & expenses, including comparatives	Closing Rate at the date of the most recent Balance Sheet

In other words, when the entity's functional as well as presentation currency is a currency of hyperinflationary economies, all items in the financial statements (current period and comparatives) are translated into the presentation currency at the closing rate at the end of the most recent period presented after being restated for the effects of inflation.

The financial statements should be restated in accordance with Ind AS 29 before translating into the presentation currency.

Currency to which if translated is currency of a non-hyper inflationary economy; comparative amounts shall not adjusted for subsequent changes in price level or subsequent changes in exchange rate.

Characteristics of Hyperinflationary economy (Ind AS 29)

- Preference of investment of wealth in a relatively stable foreign currency/ non-monetary assets
- All monetary amounts are quoted in relatively stable currency rather than local currency
- Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short
- Interest rates, wages and prices are linked to a price index
- The cumulative inflation over three years is approaching, or exceeds, 100 percent

HOW TO TRANSLATEITEMS OF FINANCIAL STATEMENTS OF A FOREIGN OPERATION?

Same as above Case 1 and Case 2 along with following points:

1. When the FS of foreign operation is of a date different from that of the reporting entity, IndAS 110 allows the use of a different date **provided that the difference is no greater than 3 months**. In such case the assets and liabilities of the foreign operations are translated at the exchange rate at the end of the reporting period of the foreign operation. Adjustments are made for significant changes in exchange rates upto the end of the reporting period of the reporting entity.
2. **Any Goodwill arising on the acquisition of a foreign operation** and any fair value adjustment to the carrying amounts of Assets and Liabilities arising on the acquisition of that foreign operation shall be treated as Assets and Liabilities of the foreign operation. Thus they shall be translated at the closing rate.
3. Share of Accumulated Exchange difference shall be proportionately allocated to Minority Interest under Consolidated Financial Statements.

4. INTRA-GROUP TRANSACTIONS:

Although intra-group balances are eliminated on consolidation, **any related foreign exchange gains or losses will not be eliminated**. This is because the group has a real exposure to a foreign currency since one of the entities will need to obtain or sell foreign currency in order to settle the obligation or realise the proceeds received.

Accordingly, **in the consolidated financial statements of the reporting entity, the exchange difference arising on such intra group transactions is recognised in the statement of profit or loss account** unless it arises from on a monetary item that forms part of a reporting entity's net investment in a foreign operation in which case it is taken to other comprehensive income and accumulated in a separate component of equity and reclassified to profit or loss only on disposal of the foreign operation;

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Q190

The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due and the exchange rate is USD 1 = Euro 2.2. How should the exchange differences be accounted for in the consolidated financial statements? **Also show the journal entries.**

Solution

At year-end, S should revalue its accounts payable to EURO 220, recognising a loss of 20 in its standalone profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate i.e., USD 100 which will get eliminated against the receivable in the books of P but the EURO 20 exchange loss recorded in the subsidiary's statement of profit and loss has no equivalent gain in the parent's financial statements. Therefore, the EURO 20 loss will remain in the consolidated statement of profit and loss.

The reason for this is that the intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the parent company. The subsidiary must go out and buy USD to settle the obligation to the parent, so the Group as a whole has an exposure to foreign currency risk.

Student Notes:-

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DISPOSAL OF A FOREIGN OPERATION

1. On disposal of foreign operation - Transfer cumulative amount of exchange difference from equity to profit and loss A/c.
2. On Partial disposal of foreign operation - Transfer proportionate share of cumulative amount of exchange difference from equity to profit and loss A/c.
3. On Partial disposal of Subsidiary that includes foreign operation – Reattribute the proportionate share of the cumulative amount of the exchange difference recognised in OCI to the Non-Controlling Interest (Minority Interest) in that Foreign Operation. **(In case of without loss of control)**
4. On Partial disposal of Subsidiary that includes foreign operation – Reclassify the proportionate share of the cumulative amount of the exchange difference recognised in OCI to the Profit and Loss A/c. **(In case of with loss of control).** Also the cumulative amount of ED already reflected as part of NON Controlling interest are Derecognized and included in the calculation of profit or loss on disposal.

Example:

A parent has 100% interest in a subsidiary for a number of years. The subsidiary has been classified as a foreign operation and Rs. 5 million relating to the translation differences of subsidiary has been recognised in other comprehensive income and accumulated in a separate component of equity. The parent disposes of 30% of its interest but retains control. What would be the treatment on the date of disposal?

Answer: Rs. 1.5 million (5*30%) of cumulative translation exchange differences are transferred within equity from foreign currency translation reserve to non-controlling interest. No amounts are reclassified to profit or loss.

Example:

A parent has 80% interest in a subsidiary for number of years. The subsidiary has been classified as a foreign operation and Rs. 5 million have been recognized in other comprehensive income. 80% have been accumulated in a separate component of equity and balance 20% attributed to non-controlling interest. The parent disposes 40% of its interest resulting in loss of control. What would be treatment on date of disposal?

Answer: Rs. 4 million (5*80%) of cumulative translation exchange differences are transferred from equity to profit and loss. Rs. 1 million already reflected as part of non-controlling interest are derecognized and included in the calculation of the profit or loss on disposal.

TAX EFFECTS OF ALL EXCHANGE DIFFERENCES

Gains and Losses on foreign currency transactions and exchange difference arising on translating the results and financial position of an entity (including foreign operation) into a different currency may have **TAX Effect. Ind AS 12 applies to these effects.**

Student Notes:-

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Additional Questions

Q191.

Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for Rs 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is Rs 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of Rs 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of Rs180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is Rs 20 lakhs

Calculate P's gain on disposal.

Q192.

Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).

The following is the statement of financial position of Infotech Global Ltd. prior to translation:

Particulars	USD	L$
PPE	50000	
Receivables	9,35,000	
Total Assets	**9,85,000**	
Issued Capital	50,000	30,055
Opening Retained Earnings	28,000	15,274
Profit for the Year	20,000	
Accounts Payable	8,40,000	
Accrued Liabilities	47,000	
Total Equity & Liabilities	**9,85,000**	

Required:

Translate the statement of financial position of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information:

Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

Rate at end of the year L$ 1 = USD 1.13

Solution:

P's gain on disposal would be calculated in the following manner:

(Rs in Lakhs)

Sale proceeds	1500
Net assets of S	(1000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

Translation of the financial statements

	USD	Rate	L$
Property, plant and equipment	50,000	1.13	44,248
Receivables	9,35,000	1.13	8,27,434
Total assets	**9,85,000**		**8,71,682**
Issued capital	50,000	—	30,055
Opening retained earnings	28,000	—	15,274
Profit for the year	20,000	1.175	17,021
Accounts payable	8,40,000	1.13	7,43,363
Accrued liabilities	47,000	1.13	41,593
Total equity and liabilities USD	**9,85,000**		**8,47,306**
Foreign Currency			**24,376**
Translation Reserve (proof below)			
Total equity and liabilities L$			**8,71,682**

Working of the cumulative balance of the FCTR:

Particulars	Actual translated amount in L$	Amount	Difference translated at closing rate of 1.13
Issued capital	30,055	44,274	14,192
Opening retained earnings	15,274	24,779	9,505
Profit for the year	17,021	17,699	678
[Difference of 1 is rounding]	**62,350**	**86,725**	**24,375**

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Q193. (RTP May 18)

On 30th January, 20X1, A Ltd. purchased machinery for $5,000 from USA supplier on credit basis. A's Ltd. functional currency is the Rupee. The exchange rate on the date of transaction is 1$= Rs 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$= Rs 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$= Rs 67. The fair value of the machinery remains unchanged for the year ended on 31st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21.

Solution:

Journal Entries

Purchase of Machinery on credit basis on 30th January 20X1:

	Rs.	Rs.
Machinery A/c (5,000 x $ 60) Dr.	3,00,000	
To Creditors		3,00,000
(Initial transaction will be recorded at exchange rate on the date of transaction)		

Exchange difference arising on translating monetary item on 31st March 20X1:

	Rs	Rs
Machinery A/c [(5,500 x $ 65) – (5,000 x $ 60)] Dr.	57,500	
To Revaluation surplus		57,500
Profit & Loss A/c [(5,000 x $ 65) – (5,000 x $ 60)] Dr.	25,000	
To Creditors		20,000

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 20X2:

	Rs.	Rs.
Creditors A/c (5,000 x $65) Dr.	3,25,000	
Profit & loss A/c [(5,000 x ($ 67 -$ 65)] Dr.	10,000	
To Bank A/c		3,35,000
Machinery A/c [(5,500*($ 67-$ 65)) Dr.	11,000	
To Revaluation Surplus		11,000

Q194. (RTP Nov. 2018)

On 1st January, 2018, P Ltd. purchased a machine for$ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1 =Rs 68. P Ltd. is not required to pay for this purchase until 30th June, 2018. Rupees strengthened against the $ in the three months following purchase and by 31st March, 2018 the exchange rate was $1=Rs 65. CFO of P Ltd. feels that the exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.

Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS.

Solution

As per Ind AS 21 'The Effects of Changes in Foreign Exchange Rates' the asset and liability would initially be recognised at the rate of exchange in force at the transaction date ie 1st January, 2018. Therefore, the amount initially recognised would be Rs 1,36,00,000 ($ 2,00 000 x ` 68).

The liability is a monetary item so it is retranslated using the rate of exchange in force at 31st March, 2018. This makes the closing liability of Rs 1,30,00,000 ($ 2,00,000 x Rs65).

The loss on re-translation of Rs 6,00,000 (Rs1,36,00,000 – Rs1,30,00,000) is recognised in the Statement of profit or loss.

The machine is a non-monetary asset carried at historical cost. Therefore, it continues to be translated using the rate of Rs68 to $ 1.

Depreciation of Rs 8,50,000 (Rs1,36,00,000 x ¼ x 3/12) would be charged to profit or loss for the year ended 31st March, 2018.

The closing balance in property, plant and equipment would be Rs1,27,50,000 (Rs1,36,00,000 – Rs1,30,00,000). This would be shown as a non-current asset in the statement of financial position.

Student Notes:-

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